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In the Supreme Court of the United States

OCTOBER TERM, 1974

CRAIG PHELPS, RECEIVER IN BANKRUPTCY IN THE MATTER OF CHICAGOLAND IDEEL CLEANERS, INC., BANKRUPT, PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

ROBERT H. BORK,
Solicitor General,
SCOTT P. CRAMPTON,
Assistant Attorney General,
KEITH A. JONES,
Assistant to the Solicitor General,
CROMBIE J. D. GARRETT,
KARL SCHMEIDLER,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

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BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The orders of the bankruptcy court (A. 15–16) and of the district court (A. 19–20) are not officially reported. The opinion of the court of appeals (Pet. App. A) is reported at 495 F. 2d 1283.

JURISDICTION

The judgment of the court of appeals (Pet. App. B) was entered on May 7, 1974. A timely petition for rehearing was denied on May 24, 1974 (A. 22). The petition for a writ of certiorari was filed on August 14,

1974, and was granted on December 16, 1974. The jurisdiction of this Court rests upon 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

1. Whether the United States, by serving the taxpayer's general assignee with a valid notice of levy, took custody of all property in the assignee's possession on which there was a federal tax lien.

2. Whether the government's claims to property that it levied upon prior to bankruptcy may be adjudicated by the bankruptcy court in a summary proceeding.

STATUTES AND REGULATION INVOLVED

The pertinent provisions of Sections 2a(21) and 67c(3) of the Bankruptcy Act, as amended, 11 U.S.C. 11(a)(21) and 107(c)(3), and Sections 6321, 6322, 6323, 6331, and 6672 of the Internal Revenue Code of 1954, as amended, 26 U.S.C. 6321, 6322, 6323, 6331, and 6672, are set forth in the appendix to petitioner's brief.

The pertinent provisions of Section 6332 of the Internal Revenue Code of 1954, 26 U.S.C. 6332, and of Section 301.6331–1(a)(1) of the Treasury Regulations on Procedure and Administration, 26 C.F.R. 301.6331–1(a)(1), are set forth at pp. 2–3 of the United States' memorandum in response to the petition for a writ of certiorari.

STATEMENT

Between March 12, 1971, and June 4, 1971, the Internal Revenue Service made assessments against

Chicagoland Ideel Cleaners, Inc., of federal income and social security withholding taxes and federal unemployment taxes, for the period from July 1, 1970, to March 31, 1971, in the total amount of $140,831.59 (see App. 13). Chicagoland failed to pay these taxes after formal demand for payment. Instead, on June 28, 1971, Chicagoland assigned all its property to an individual, Nathan Yorke, as assignee for the benefit of its creditors (App. 5–8). Yorke liquidated the property and held the proceeds (App. 9).[1]

On August 25, 1971, the Service filed a notice of its tax lien for the taxes previously assessed, served Yorke with a notice of levy, and demanded payment. The notice of tax lien stated that $140,831.59 in taxes had been assessed against Chicagoland and that "after demand for payment thereof [the taxes] remained unpaid" (App. 13). The notice of levy informed petitioner that (App. 14):

> * * * demand has been made for the amount set forth herein upon the taxpayer who has neglected or refused to pay * * *. Accordingly, * * * all property, rights to property, moneys, credits and bank deposits now in your possession and belonging to this taxpayer (or with respect to which you are obligated) and all sums of money or other obligations owing from you to this taxpayer, or on which there is a [federal tax] lien * * * are hereby levied upon and seized for satisfaction of the aforesaid tax * * *,

[1] We have been informed by the referee in bankruptcy that the proceeds, including accumulated interest, now amount to approximately $38,000, and by petitioner's counsel that on the date of levy Yorke was holding them in a bank account pending distribution to creditors.

> and demand is hereby made upon you for the amount necessary to satisfy the liability set forth herein, or for such lesser sum as you may be indebted to him * * *.

On September 14, 1971, an involuntary petition in bankruptcy was filed against Chicagoland. Petitioner was appointed receiver in bankruptcy, and Chicagoland was adjudicated bankrupt. Petitioner then filed an application with the referee in bankruptcy for an order requiring the assignee, Yorke, who had not yet complied with the Service's demand for payment, to turn over to petitioner the proceeds from the sale of Chicagoland's assets (App. 9–10). Despite the objection of the United States that the bankruptcy court lacked jurisdiction (App. 10–11), the referee ordered the proceeds turned over to petitioner (App. 15–16). The district court affirmed (Pet. App. C; App. 19–20). The court of appeals reversed (Pet. App. A), holding that the levy had transferred possessory interest in the proceeds to the United States and, therefore, that the bankruptcy court lacked summary jurisdiction to order the proceeds paid over to petitioner.

SUMMARY OF ARGUMENT

I

A. Under Section 6331(a) of the Internal Revenue Code, the United States may proceed administratively by levy to collect unpaid federal tax liabilities. The levy power extends to, *inter alia,* all property and rights to property, including intangible property, on which there is a lien arising on account of the taxpayer's liability.

A valid levy on intangible property held by a third person is effected by serving that person with a formal notice of levy. See, *e.g., Sims* v. *United States,* 359 U.S. 108, 110–111. The effect of the notice of levy is to designate the person served as the government's custodian with respect to the property subject to levy.

These general principles are not controverted by petitioner. It is therefore clear that the service of notice of levy upon the taxpayer's assignee in this case made the assignee the government's custodian with respect to all intangible property in his possession on which there was a lien arising on account of the taxpayer's liability.

B. Petitioner contends, however, that at the time of the service of notice of levy here, the taxpayer's general assignee was not holding any property on which there was a levy. This contention borders on the frivolous.

Petitioner concedes, as he must, that the assignee took the taxpayer's property subject to the government's lien. But it is also clear that when the assignee subsequently sold or liquidated that property, the government's lien attached to the proceeds in substitution. It has anciently been the case, under controlling federal common law, that "the lien re-attaches * * * to whatever is substituted for [the property to which the lien originally attached]." *Sheppard* v. *Taylor,* 5 Pet. 675, 710. And this Court has expressly held, with limitations not here relevant, that a federal tax lien attaches to proceeds received by a transferee in substitution for the taxpayer's original property. *United*

States v. *Bess*, 357 U.S. 51. The same result would follow under Illinois law.

Accordingly, the proceeds held by the assignee remained subject to levy as intangible property on which there was a lien, and the service of the notice of levy had the effect of placing those proceeds in the custody of the United States. See *N.H. Fire Ins. Co.* v. *Scanlon*, 362 U.S. 404.

II

A. A third person's substantial claims to property in its actual or constructive possession may not be adjudicated by the bankruptcy court in a summary proceeding; the bankruptcy court lacks jurisdiction summarily to order such property turned over to the receiver for administration as part of the bankrupt estate. See generally Collier, *Bankruptcy*, paras. 23.04 and 23.10 (14th ed.). To reach such property, the receiver must institute a plenary suit under Section 23 of the Bankruptcy Act. Petitioner does not appear to contest these general principles.

The application of these principles to this case is, in our view, a straightforward matter: the government's levy established a custodial relationship between the assignee and the United States and thereby reduced the proceeds to the United States' constructive possession; accordingly, the proceeds are not subject to summary turnover. Following the levy, actual possession of the proceeds was held by the assignee on behalf of the United States, and "where possession is assertedly held not for the bankrupt, but for others prior to bankruptcy * * *, the holder is

not subject to summary jurisdiction." 2 Collier, *supra*, para. 23.06[3].

This result serves the government's legitimate interest in orderly tax collection. If the government could not rely upon its levy upon intangible property as conferring constructive possession for Bankruptcy Act purposes, it would be forced to engage in an unseemly scramble for actual possession of such property whenever the taxpayer was believed to be in precarious financial circumstances. That process might entail considerable disruption and inconvenience for taxpayers and third parties subject to levy. Moreover, it is by no means clear how some forms of intangible property, such as, for example, accounts receivable and causes of action, could be quickly reduced to actual possession. Accordingly, for practical reasons of internal revenue collection, as well as for established reasons of bankruptcy law, the government should be able to rely upon a valid prebankruptcy levy as removing the intangible property subject to levy from the reach of summary turnover orders.

B. This result is not changed by the provisions of the Bankruptcy Act upon which petitioner relies.

Section 67c(3) of that Act has no bearing on the question of summary jurisdiction; it relates only to the priority that is to be accorded tax liens on property that has already been determined to be within the court's jurisdiction as part of the bankrupt estate. Moreover, it is addressed only to the question of the priority of tax *liens*, not to the effect of tax *levies*.

Sections 2a(21) and 70a(8) of the Bankruptcy Act grant the bankruptcy court power to order turnover only of property held by a general assignee in his capacity as "mere naked bailee for the creditors * * *." *In re McCrum,* 214 Fed. 207, 209 (C.A. 2). Property held by an assignee after an effective levy, in his capacity as the government's agent or custodian, is not subject to summary turnover under those provisions.

C. Accordingly, under long accepted bankruptcy principles, the United States, as an adverse claimant in constructive possession, is entitled to have its claims adjudicated in a plenary proceeding. This conclusion is further bolstered by two nonbankruptcy considerations.

First, the government's possessory claims generally are not subject to summary adjudication, and this is especially the case with regard to "[p]roperty seized by a revenue officer for delinquent taxes * * *." *N.H. Fire Ins. Co.* v. *Scanlon, supra,* 362 U.S. at 408.

Second, petitioner's suit for summary turnover is designed to prevent the assignee from fulfilling his statutory obligation of surrendering property to the United States pursuant to a levy and is therefore barred by Section 7421 of the Internal Revenue Code, which provides that "no suit for the purpose of restraining the * * * collection of any tax shall be maintained in any court by any person * * *."

ARGUMENT

I

BY SERVING THE TAXPAYER'S GENERAL ASSIGNEE WITH A VALID NOTICE OF LEVY, THE UNITED STATES TOOK CUSTODY OF ALL PROPERTY IN THE ASSIGNEE'S POSSESSION ON WHICH THERE WAS A FEDERAL TAX LIEN

A. A NOTICE OF LEVY PLACES THE INTANGIBLE PROPERTY SUBJECT TO LEVY IN THE CUSTODY OF THE UNITED STATES

In situations where a tax liability remains unpaid after the filing of a return, or where no return has been filed, the formal process of internal revenue collection begins with the "assessment" of tax pursuant to Section 6201 of the Internal Revenue Code of 1954, 26 U.S.C. 6201. The assessment is an administrative determination of the amount of the taxpayer's outstanding unpaid tax liability. Within 60 days of the making of the assessment, the taxpayer is notified of the amount of his unpaid tax liability, and demand for payment is made. See Section 6303 of the Internal Revenue Code.

If the taxpayer neglects or refuses to pay the tax after demand, the amount of the tax, together with interest and penalties, "shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to [the taxpayer]." Section 6321 of the Code. The tax lien

relates back to the date of assessment (Section 6322 of the Code), and it attaches to after-acquired property. *Glass City Bank* v. *United States*, 326 U.S. 265. The lien is valid *ab initio* as against the taxpayer's unsecured creditors, and also as against transferees who do not furnish full and fresh consideration. See *United States* v. *City of New Britain*, 347 U.S. 81, 88 (noting that Congress intended federal tax liens to rank ahead of all interests not specifically protected by statute); Section 6323(h)(6) of the Code (providing that the only purchasers protected against unfiled tax liens are those who furnish "adequate and full consideration in money or money's worth"); *Filipowicz* v. *Rothensies*, 43 F. Supp. 619 (E.D. Pa.) (holding that assignees for past due consideration take subject to an unfiled tax lien). Once a notice of lien is filed pursuant to Section 6323(f) of the Code, the lien is also valid as against subsequent purchasers, holders of security interests, mechanic's lienors, and judgment lien creditors. See Section 6323(a) of the Code; *United States* v. *Leventhal*, 316 F. 2d 341 (C.A.D.C.); *Bank of Nevada* v. *United States*, 251 F. 2d 820 (C.A. 9).

If after assessment and demand the taxpayer's liability remains unpaid, the government may proceed administratively to collect the tax by levy.[2] See Section 6331 of the Code. This "right of the United

[2] The United States is not, of course, limited to administrative collection procedures. For example, the government could bring a civil action in federal district court to enforce its tax lien. See Section 7403 of the Code. But we are concerned here only with the scope and effect of the administrative remedy.

States to collect its internal revenue by summary administrative proceedings has long been settled." *Phillips* v. *Commissioner*, 283 U.S. 589, 595. See also *Springer* v. *United States*, 102 U.S. 586, 593–594; *Murray's Lessee* v. *Hoboken Land and Improvement Co.*, 18 How. 272, 277–278.

The levy power extends to two broad overlapping categories of property—(1) "all property and rights to property * * * belonging to [the taxpayer]" (Section 6331(a) of the Code) and (2) all property and rights to property "on which there is a lien" (*ibid.*). In almost all circumstances, except where the tax lien has been released pursuant to Section 6325 of the Code, the property belonging to the taxpayer will also be property "on which there is a lien." See Section 6321 of the Code; *Glass City Bank* v. *United States*, *supra*. The converse, however, is not true, for there may be many instances in which property "on which there is a lien" no longer belongs to the taxpayer. For example, a donative conveyance that is effective under state law to transfer legal and equitable title from the taxpayer to the donee nevertheless does not free the property from a pre-existing federal tax lien. See, *e.g.*, *United States* v. *Mitchell*, 413 F. 2d 181 (C.A. 7). Such property therefore remains subject to levy under Section 6331 of the Code.

Both tangible and intangible property are subject to levy. Section 6331(b) of the Code makes this explicit by providing that the government may, in the exercise of its levy power, "seize and sell * * * property or rights to property (whether real or personal,

tangible or intangible)." And this Court has frequently sustained levies on intangible property. See, *e.g., Sims* v. *United States,* 359 U.S. 108, 110–111.

Levy upon tangible property normally is effected by service of a Levy (Form 668–B) or Notice of Levy (Form 668–A) and physical seizure of the property.[3] Where physical seizure is not feasible, the property is posted or tagged in a manner that indicates that it has been taken into the government's custody. Since intangible property is not susceptible to physical seizure, posting, or tagging, levy upon intangible property is effected by serving the appropriate form upon the person holding the property or rights to property: "[l]evy may be made by serving a notice of levy on any person in possession of, or obligated with respect to, property or rights to property subject to levy including receivables, bank accounts, evidences of debt, securities, and accrued salaries, wages, commissions, and other compensation." Section 301.6331–1(a)(1) of the Treasury Regulations on Procedure and Administration, 26 C.F.R. 301.6331–1(a)(1).

The standard notice of levy, which was served upon the assignee in this case, notifies the person served that "all property, rights to property, moneys, credits, and bank deposits now in your possession and belonging to this taxpayer * * * and all sums of money or other obligations owing from you to this taxpayer, or

[3] The Levy is served upon the taxpayer; the Notice of Levy is served upon third persons. When service is made upon a third person, a copy of the Notice of Levy is furnished to the taxpayer.

on which there is a lien * * * are hereby levied upon and seized" (App. 14). A formal demand for payment is printed on the notice (*ibid.*).

Service of notice of levy, accompanied by demand, effects a valid levy upon intangible property. See, *e.g., Sims* v. *United States, supra.* Such a levy reaches (1) all the taxpayer's intangible property in the hands of the person served, including any debts he owes to the taxpayer, and (2) any property that that person holds in his possession on which there is a lien arising on account of the taxpayer's liability. See Section 6331(a) of the Code.

Following levy and demand, the property levied upon "belongs", in a very real sense, to the United States. The person holding actual possession of the property does so as the government's agent, custodian, or bailee. If that person fails or refuses after demand to surrender the property subject to levy, he becomes personally liable to the United States for "a sum equal to the value of the property or rights not so surrendered." Section 6332(c)(1) of the Code. Thus service of a standard notice of levy, which includes a demand for surrender of the property, is tantamount to a transfer of ownership of the intangible property levied upon to the United States: the levy places the intangible property in custody for the benefit of the United States. See *N.H. Fire Ins. Co.* v. *Scanlon,* 362 U.S. 404. See also *United States* v. *Pittman,* 449 F. 2d 623 (C.A. 7); *In re Cherry Valley Homes, Inc.,* 255 F. 2d 706 (C.A. 3), certiorari denied *sub nom. DuBois, Trustee* v. *United States,* 358 U.S. 864; *United States* v. *Eiland,* 223 F. 2d 118 (C.A. 4).

B. THE PROPERTY HERE AT ISSUE WAS SUBJECT TO LEVY

Under the principles set forth above (pp. 9–13, *supra*), the service of the notice of levy upon the assignee, Yorke, effected a valid levy upon, and transferred to the government's custody, all property in Yorke's possession on which there was a lien arising on account of the taxpayer's tax liability.[4] Petitioner does not directly contest this point. He argues (Br. 8–13) instead that the government's lien did not attach to the proceeds received by Yorke from the sale of the assigned property and therefore that at the time of levy Yorke held no property "on which there [was] a lien." Section 6331(a) of the Code.[5] That argument, we believe, borders on the frivolous. It is clear under both federal and Illinois law that a lien attaches to the proceeds from the sale of encumbered property and that, in particular, the government's lien here attached to the proceeds derived from Yorke's sale of the assigned property.

[4] The levy also reached all property of the taxpayer then in Yorke's possession, including any debt that he owed to the taxpayer. However, petitioner contends (Br. 13–16) that under Illinois law the assignment vested legal and equitable title to the assigned property in Yorke as trustee for the benefit of creditors and therefore that Yorke held no property of, and owed no debt to, the taxpayer. We do not here contest petitioner's reading of Illinois law on these matters.

[5] Much of petitioner's discussion on this point is in support of the proposition, which we do not challenge, that the government's unfiled lien would not follow the assigned property into the hands of good faith purchasers from the assignee. But the government is not attempting to reach the property in the hands of those purchasers. The government's claim is to the proceeds in the hands of the assignee.

1. Yorke took the assigned property subject to the government's lien

Tax assessments were made against Chicagoland between March 12, 1971, and June 4, 1971. The government's lien attached to Chicagoland's property at the time those assessments were made. Chicagoland assigned all its property to Yorke on June 28, 1971. It is undisputed that Yorke took the property subject to the government's lien.[6]

If the assigned property remained in Yorke's hands on August 25, 1971, the date on which the government filed its notice of lien and served Yorke with a notice of levy, there could be no doubt that that property was subject to levy as property "on which there [was] a lien." Section 6331(a) of the Code. Petitioner asserts (Br. 10), however, that Yorke had sold or otherwise liquidated the assigned property before August 25, 1971, and that on that date Yorke was holding only the proceeds of that liquidation. See note 2, *supra*. Although the record sheds no light on that matter, we are willing to accept petitioner's assertion as factually correct.

[6] On the date of assignment, the government's unfiled tax lien was effective as against all third persons other than purchasers, holders of secured interests, mechanic's lienors, and judgment lien creditors. See p. 10, *supra*. Petitioner correctly concedes (Br. 11) that Yorke did not fall within any of those categories. Under Illinois law, a general assignee is not a purchaser but rather an agent for the distribution of the assignor's property, which he takes subject to all outstanding liens. See, *e.g.*, *Sanner* v. *Sanner*, 257 Ill. App. 305; *Columbia Hardwood Lumber Co.* v. *Brandenberger*, 82 Ill. App. 327; *Home Savings and State Bank* v. *Wheeler*, 74 Ill. App. 261.

2. The lien attached to the proceeds in substitution

State law controls the question whether a taxpayer has a property right subject to lien under Section 6321 of the Code. See, *e.g., Aquilino* v. *United States,* 363 U.S. 509. But once it has been established that a lien exists, federal law controls the question whether the lien remains effective upon a transfer or substitution of the property subject to lien. See *United States* v. *Bess,* 357 U.S. 51. And it is clear, under federal law, that the government's lien in this case remained effective upon the substitution of the proceeds for the property in the hands of the assignee.

Indeed, one of the most ancient doctrines of federal common law is that a lien attaches to the proceeds from the sale of the property subject to the lien. As Justice Story stated in *Sheppard* v. *Taylor,* 5 Pet. 675, 710:

> * * * the lien re-attaches to the thing and to whatever is substituted for it. This is no peculiar principle of the admiralty. It is found incorporated into the doctrines of courts of common law and equity. The owner and the lienholder, whose claims have been wrongfully displaced, may follow the proceeds, wherever they can distinctly trace them.

We know of no contrary authority. Accordingly, since Yorke, the assignee here, sold property that was subject to the government's lien in his hands, the lien attached to the proceeds.[7]

[7] In making this contention, we do not rely upon any property right that Chicagoland may have retained in the proceeds. Of course, if the proceeds were property of Chicagoland under state law, a lien would automatically attach under Section 6321 of the Code. See *Glass City Bank* v. *United States, supra.*

In contesting this point, petitioner relies (Br. 15), apparently exclusively, upon *United States* v. *Bess, supra.* But *Bess* in fact supports our position. In that case, this Court held that the tax lien on an insured-taxpayer's policy of life insurance follows and attaches to the insurance proceeds in the hands of the beneficiary, to the extent of the cash surrender value of the policy in the taxpayer's hands prior to death. In short, subject to the limitation that the lien does not attach to an element of value not realizable by the taxpayer, under federal law the government's lien attaches to proceeds received by a transferee in substitution for the taxpayer's original property.

Petitioner would fare no better under Illinois law. Illinois law has long provided that where an assignee takes property subject to a lien, the lien attaches to the proceeds from the assignee's sale of that property. See, *e.g., Black* v. *Palmer,* 15 Ill. App. 2d 207, 145 N.E. 2d 797; *Loeber* v. *Leininger,* 175 Ill. 484, 51 N.E. 703; *Hooven* v. *Burdette,* 153 Ill. 672, 39 N.E. 1107.

The reason for this generally accepted rule of common law is, of course, not difficult to perceive. Any other rule would permit transferees to defeat a lien by the simple, if unscrupulous, expedient of selling or exchanging the property; the interest of the lienholder in preserving his security is entitled to greater protection than that. The rule petitioner suggests, as applied in the context of internal revenue collection, would permit a taxpayer to evade a lien by transferring his property to a donee who, although taking subject to the lien (see p. 11, *supra*), could then sell the property and retain the proceeds free of lien. Such a

result would serve no legitimate purpose and would improperly interfere with efforts at tax collection.

To summarize, since Yorke took Chicagoland's property subject to the government's lien, the lien attached to the proceeds from the sale of that property in Yorke's hands; as property "on which there [was] a lien" (Section 6331(a) of the Code), the proceeds were subject to levy by service of notice of levy upon Yorke.

II

THE GOVERNMENT'S CLAIMS TO PROPERTY THAT IT LEVIED UPON PRIOR TO BANKRUPTCY MAY NOT BE ADJUDICATED BY THE BANKRUPTCY COURT IN A SUMMARY PROCEEDING

We have shown above (pp. 9–18, *supra*) that prior to the bankruptcy of the taxpayer, Chicagoland, the United States had, by levy, taken custody of the proceeds being held by Chicagoland's assignee. Our further contention here is that the United States is entitled as against petitioner, the receiver in bankruptcy, to retain custody and control of those proceeds, and to take any necessary additional steps to reduce them to its actual possession, unless and until petitioner establishes in a plenary judicial proceeding that the government's underlying tax claim is itself invalid.[8] In short, we contend that property levied upon by the government prior to bankruptcy may not be ordered

[8] Neither the taxpayer nor petitioner has challenged the validity of the government's tax claim.

turned over to the receiver by the bankruptcy court in a summary proceeding.

The difference between a summary and plenary proceeding in this context is not merely a matter of the relative formality of the respective procedures. The consequence of a summary turnover order is to subject the property in question to administration as part of the bankrupt estate. Where the government has a tax lien on the property, the consequence of the turnover is to subordinate that lien to the expenses of administration and priority wage claims. See Section 67c(3) of the Bankruptcy Act, 11 U.S.C. 107(c)(3). In contrast, if the property is not subject to summary turnover, it may be brought into the bankrupt estate only if the receiver is able to defeat the government's underlying tax claim in a plenary proceeding, *i.e.*, a suit for refund. Thus, in a case where the underlying tax claim is sound, for the government the difference between a summary and a plenary proceeding is the difference between holding the property subject to prior payment of administrative and priority wage claims and holding it outright.

It is undisputed that where the government has only a bare lien, without the constructive possession conferred by levy, the encumbered property is subject to summary turnover. But we now show that where the government additionally has levied upon the property prior to bankruptcy, the property cannot be summarily ordered turned over to the receiver for administration as part of the bankrupt estate.

A. AS A GENERAL RULE, A THIRD PERSON'S CLAIMS TO PROPERTY IN ITS ACTUAL OR CONSTRUCTIVE POSSESSION MAY NOT BE ADJUDICATED IN A SUMMARY PROCEEDING

This case arises from petitioner's request that the bankruptcy court order that the property levied upon by the government prior to bankruptcy be turned over to petitioner for administration as assets of the bankrupt estate. By that request, petitioner sought to invoke the bankruptcy court's summary jurisdiction; "[i]n order to secure a turnover order, the receiver or trustee must first of all establish the summary jurisdiction of the court, except where the defendant consents." 2 Collier, *Bankruptcy*, para. 23.10 [2] (14th ed.).

The general principles governing the scope of a bankruptcy court's summary jurisdiction have been correctly stated as follows (2 Collier, *supra*, para. 23.04[2]):

> Generally speaking, where the controversy is one concerning property in the actual or constructive possession of the bankruptcy court, that court may adjudicate summarily all rights and claims pertaining thereto. Where the controversy is one involving property in the actual or constructive possession of a third person asserting a *bona fide* adverse claim, the bankruptcy court has no jurisdiction to determine summarily that person's claim upon petition by the receiver or trustee, unless by that person's consent. Without the consent of the adverse claimant, a plenary suit must be

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> brought in the court of appropriate jurisdiction * * *.[9]

These principles have been repeatedly applied to bar summary turnover of property in the actual or constructive possession of an adverse claimant; to reach such property, the receiver or trustee must institute a plenary suit under Section 23 of the Bankruptcy Act, in which the respective rights of the contending claimants may be determined. See, *e.g.*, *Taubel, Etc., Co.* v. *Fox*, 264 U.S. 426, 433–434; *Thompson* v. *Magnolia Co.*, 309 U.S. 478; *Cline* v. *Kaplan*, 323 U.S. 97, 98–99; *United States* v. *Owens*, 329 F. 2d 678, 680 (C.A. 5); *In re American National Trust*, 426 F. 2d 1059 (C.A. 7). In short, property in the actual or constructive possession of a third person who asserts a *bona fide* adverse claim is not subject to turnover, and such an adverse claimant is entitled to have his claims adjudicated in a plenary action. See, generally, 2

[9] Petitioner apparently contends (Br. 7, 24–25) that the United States' intervention as an adverse claimant in the bankruptcy court's proceeding constituted an acquiescence in the exercise of summary jurisdiction. However, the United States' answer to petitioner's application for summary turnover expressly stated that "[t]his court of bankruptcy lacks jurisdiction over the subject matter of the application" (App. 10) and that "the United States has not and does not consent to the adjudication of the controversy" (App. 11). As an adverse claimant in constructive possession of the proceeds, the United States was entitled to refuse to consent to a summary adjudication, and it stated its refusal in a clear and timely fashion. There was no acquiescence in the exercise of summary jurisdiction.

Collier, *supra*, para. 23.06. We do not understand petitioner to contest these general principles, which are, in any event, well established.

The application of these principles to this case is, in our view, a straightforward matter: the government's levy upon the proceeds in the hands of the assignee established a custodial relationship between the assignee and the United States (see pp. 9–18, *supra*) and thereby reduced the proceeds to the United States' constructive possession; accordingly, the proceeds are not subject to turnover; instead, the United States, as an adverse claimant to proceeds in its constructive possession, is entitled to have its claims adjudicated in a plenary action. *Rosenblum* v. *United States*, 300 F. 2d 843 (C.A. 1); *United States* v. *Eiland*, *supra*. Cf. *United States* v. *Pittman*, *supra*; *In re Brewster-Raymond Co.*, 344 F. 2d 903 (C.A. 6).

The Ninth Circuit reached a contrary result in *In re United General Wood Products Corp.*, 483 F. 2d 975. The court held that where the person in actual possession of the property (in this case, the assignee, Yorke) was not himself an adverse claimant, the bankruptcy court has summary jurisdiction to order the property turned over to the receiver. But the court rested that result upon the erroneous assumption that "[c]laims of third persons [in this case, the United States] to the same asset are irrelevant to the jurisdictional issue." 483 F. 2d at 976. In other words, the court implicity proceeded on the erroneous theory that in order to avoid a turnover order, the adverse claimant must have actual, and not merely constructive,

possession. The law is clearly to the contrary (2 Collier, *supra*, para. 23.06[3]; footnotes omitted):

> Where a third person holds possession of the bankrupt's property, and makes no adverse claim to it, that person will be subject to summary jurisdiction even though others make claims adverse to the bankrupt. But where possession is assertedly held not for the bankrupt, but for others prior to bankruptcy * * *, the holder is not subject to summary jurisdiction.

See, *e.g.*, *First Nat. Bank* v. *Title & Trust Co.*, 198 U.S. 280; *In re American Southern Pub. Co.*, 426 F. 2d 160 (C.A. 5); *Buss v. Long Island Storage Warehouse Co.*, 64 F. 2d 338 (C.A. 2). See generally the cases cited at 2 Collier, *supra*, para. 23.06[3], nn. 30 and 31.[10]

In this case, once the notice of levy and demand had been served upon Yorke, the general assignee, he held the proceeds not for the bankrupt or its general creditors but solely for the United States. Yorke held actual possession of the proceeds as custodian or bailee for the United States, which held constructive possession; following levy and demand the bankrupt retained no possessory interest, and consequently petitioner, whose rights derive from those of the bank-

[10] The Ninth Circuit in *In re United General Wood Products* purported to rely upon *Taubel, Etc., Co.* v. *Fox*, *supra*. But in that case this Court merely held that property in the hands of a non-adverse third person, who was not holding it as agent for any adverse claimant, was subject to summary turnover. That is not the situation here, for the assignee, Yorke, was holding the property for the United States, an adverse claimant.

rupt, acquired no such interest upon the subsequent bankruptcy. Accordingly, following levy and demand the proceeds were not subject to turnover in Yorke's hands.

This result serves the legitimate governmental interest in orderly tax collection. If the government could not rely upon its levy upon intangible property as conferring constructive possession for Bankruptcy Act purposes, it would be forced to engage in an unseemly scramble for actual possession of such property whenever the taxpayer was believed to be in precarious financial circumstances. That process might entail considerable disruption and inconvenience for third parties subject to levy, and for the taxpayer as well. Moreover, it is by no means clear how some forms of intangible property, such as, for example, accounts receivable and causes of action, could be quickly reduced to actual possession. Accordingly, for practical reasons of internal revenue collection, as well as for established reasons of bankruptcy law, the government should be entitled to rely upon a valid prebankruptcy levy as removing the intangible property subject to levy from the reach of summary turnover orders.

Petitioner offers two reasons why, in his view, this result should not follow. He contends, first, that Section 67c of the Bankruptcy Act requires that the United States establish actual possession of property that has been levied upon in order to avoid turnover of that property (Br. 20–22) and, second, that Sections 2a(21) and 70a(8) of the Bankruptcy Act require turnover of the assets held by a

general assignee without regard to any supervening government levy (Br. 23–24). For the reasons that we now discuss, neither of these contentions has merit.

B. IN PARTICULAR, PROPERTY HELD BY A GENERAL ASSIGNEE AS THE GOVERNMENT'S BAILEE IS NOT SUBJECT TO SUMMARY TURNOVER

1. The postponement provision of Section 67c of the Bankruptcy Act has no bearing upon the question of summary jurisdiction

Petitioner's reliance upon the postponement provision of Section 67c of the Bankruptcy Act is entirely misplaced.[11] That provision speaks not to the scope of the bankruptcy court's summary jurisdiction to order property turned over to the receiver, but only to the priority that is to be accorded tax liens on property that has already been determined to be within the court's jurisdiction. Section 67c(3) is a rule of bankruptcy administration that governs the distribution of the bankrupt estate, not a jurisdictional rule for determining whether property may be summarily ordered turned over to the estate in the first place. See 4 Collier, *supra*, para. 67.27[5].[12] That

[11] Section 67c(3) of the Bankruptcy Act, the "postponement" provision, subordinates "tax lien[s] on personal property not accompanied by possession" to claims for administrative expenses and wage claims under Section 64a(1) and (2).

[12] Indeed, the scope of the postponement provision is not even coterminous with the bankruptcy court's jurisdiction over property subject to liens. For example, although the bankruptcy court may summarily order turnover of real property in the bankrupt's possession, tax liens on such property are not postponed under Section 67c(3). But, in our view, the postponement provision is coterminous with the bankruptcy court's jurisdiction as to personal property subject to tax liens. Section 67c(3) postpones tax liens on personal property not within the

postponement provision is therefore irrelevant to this case.

The irrelevancy of Section 67c(3) here also is made manifest by the fact that that statute is addressed only to the question of the priority of tax liens, not to the effect of tax *levies*. If the government were asserting only its tax lien, this case would never have arisen.[13] A tax lien, standing alone, concededly would not have conferred upon the government constructive possession of the proceeds in the assignee's hands, and those proceeds would therefore have been subject to summary turnover.[14] See *Taubel, Etc., Co.* v. *Fox,*

government's "possession," which we understand to include both actual and constructive possession, and therefore by its terms applies only to personal property that is subject to summary turnover. We of course disagree with petitioner's claim (Br. 21–22) that this Court held, in *Coggin* v. *California Labor Dir.*, 336 U.S. 118, that Section 67c(3) refers only to actual and not to constructive possession. The Court there spoke in terms of actual possession merely because the facts showed such possession; no question of constructive possession was raised in that case. But the matter is in any event academic in the context of this case, for the scope of Section 67c(3) is not now before the Court.

[13] It may be noted, however, that the government's lien here satisfies the requirements of Section 67c(1) of the Bankruptcy Act, which renders invalid, as against the receiver or trustee, "every statutory lien which first becomes effective upon the insolvency of the debtor * * * [or] which is not perfected or enforceable at the date of bankruptcy against * * * bona fide purchaser[s] * * *." The government's lien under Section 6321 of the Code became effective as of the date of the assessment of taxes and it was perfected as against bona fide purchasers upon the filing of the notice of lien prior to bankruptcy.

[14] But even in those circumstances Section 67c(3) would be irrelevant to the threshold question of jurisdiction; that provision would come into play only upon the subsequent distribution of the bankrupt's estate.

supra. But the government's prebankruptcy levy here makes a crucial difference. By transferring the proceeds into the custody of the United States prior to bankruptcy, the levy removed those proceeds from the reach of the bankruptcy court's summary jurisdiction. Nothing in Section 67c is to the contrary.

2. Sections 2a(21) and 70a(8) of the Bankruptcy Act do not grant the bankruptcy court summary jurisdiction to order turnover of property held by an assignee as custodian for the United States

Section 2a(21) of the Bankruptcy Act grants bankruptcy courts jurisdiction to "[r]equire * * * assignees for the benefit of creditors * * * to deliver the property in their possession or under their control to the receiver * * *." This provision, which was enacted in 1938, "is simply declaratory of prior case law." 1 Collier, *supra,* para. 2.78[3]. That prior case law permitted summary turnover only where the assignee held possession as, in essence, the creditors' bailee (*In re McCrum,* 214 Fed. 207, 209 (C.A. 2)):

> The assignee under such conditions is not an adverse claimant, but merely the agent of the assignor for the distribution of the proceeds of the property, and as such agent his possession is that of the principal. He is a mere naked bailee for the creditors and has no right to retain the possession as against the trustee in bankruptcy.

In contrast, in this case the government's levy had the effect of terminating the agency relationship between the taxpayer and the assignee and the bailment relationship between the assignee and the taxpayer's creditors.

After the levy, Yorke held the proceeds here in question not as an assignee for the benefit of creditors but as the agent, custodian, or bailee of the United States (see p. 13, *supra*). Accordingly, the proceeds were not subject to summary turnover in his hands.

The purpose of Sections 2a(21) and 70a(8)[15] is merely to enable the receiver in bankruptcy to reach assets in the hands of the assignee in the same manner as if they were still in the hands of the bankrupt. In our view, this case would not be significantly different if there had never been a general assignment for the benefit of creditors: a levy upon intangible property in the hands of the taxpayer prior to bankruptcy would have had the effect of removing that property from the reach of the bankruptcy court's power to order summary turnover. Such a levy would, for the reasons discussed above (pp. 9–13, *supra*), have placed the intangible property in custody for the benefit of the United States, and, accordingly, after bankruptcy the United States could have asserted its constructive possession as against the bankrupt or the receiver in bankruptcy. The bankrupt in such circumstances would have held the property not in his own right but

[15] Section 70a(8) simply vests the receiver "with the title of the bankrupt as of the date of filing the petition * * * to * * * property held by an assignee for the benefit of creditors * * *." Although petitioner purports to rely upon this provision (Br. 24), he in fact shows (Br. 13–16) that the bankrupt itself had no title in the property following the assignment. See note 4, *supra*. In any event, whether or not the bankrupt held title under Illinois law prior to the levy, the prebankruptcy levy acted to vest title in the United States for all Bankruptcy Act purposes.

as the mere agent or bailee of the United States, and property so held is not subject to administration as part of the bankrupt's estate. See generally 4A Collier, *supra*, para. 70.18[4].

In short, Sections 2a(21) and 70a(8) were not intended to invalidate, and do not have the effect of invalidating, a prebankruptcy levy upon a general assignee. Those provisions simply grant the bankruptcy court summary power to reach property still held by a general assignee in his capacity as assignee: they do not affect the United States' right to a plenary adjudication of its right to retain property on which it levied prior to bankruptcy.

C. THE UNITED STATES' POSSESSORY INTEREST IN PROPERTY THAT IT HAS LEVIED UPON MAY BE CHALLENGED BY PETITIONER ONLY IN A PLENARY PROCEEDING FOLLOWING THE FILING OF A CLAIM FOR REFUND

The above discussion establishes that the United States, as an adverse claimant in constructive possession, is entitled to have its claims adjudicated in a plenary proceeding, and that the property it claims is not subject to summary turnover. The considerations we have adduced so far would apply generally to any adverse claimant. But two additional considerations, uniquely applicable to the United States, are also present here that further and conclusively demonstrate that the bankruptcy court lacked jurisdiction over petitioner's request for summary turnover: the United States' possessory interest in property that it has levied upon may not be terminated in a summary proceeding, and no proceeding of any kind,

whether summary or plenary, may be instituted, without first filing a claim for refund, to recover a tax alleged to have been erroneously collected.

1. The United States is entitled to an adjudication of its claims in a plenary proceeding

In *N.H. Fire Ins. Co.* v. *Scanlon, supra,* the United States had, as here, levied upon intangible property of a taxpayer (in that case, a debt) by serving notice of levy upon a third person (in that case, the debtor). An insurance company then brought a summary proceeding to quash the levy, on the ground that the debt was owed to the insurance company and not to the taxpayer. This Court held that the district court lacked summary jurisdiction to adjudicate the matter.

The Court first discussed the nature of summary proceedings (362 U.S. at 406–407; footnotes omitted):

> Summary trial of controversies over property and property rights is the exception in our method of administering justice. * * * Summary trials * * * may be conducted without formal pleadings, on short notice, without summons and complaints, generally on affidavits, and sometimes even *ex parte*. Such summary trials, it has been said, were practically unknown to the English common law and it may be added that they have had little acceptance in this country.

The Court then determined that summary proceedings were particularly inappropriate for the adjudication of the United States' rights to property that had

been levied upon in the course of internal revenue collection (362 U.S. at 407–408):

> * * * when a controversy like this is begun by peremptory seizure * * *, there is neither justification nor authority for carving out an exception to the uniform and regular civil procedure laid down by the Federal Rules, either for the benefit of the party from whom the property was seized or for any other claimant.
>
> * * * * *
>
> Property seized by a revenue officer for delinquent taxes is lawfully held by that officer in his administrative capacity and he has broad powers over such property.

By the same token, the summary procedures invoked by petitioner are inappropriate here. As in *N.H. Fire Ins.*, the government here seized and took custody of intangible property through service of notice of levy. Petitioner may adjudicate the lawfulness of that seizure through a plenary proceeding. See pp. 32–33, *infra*. But he is not entitled to a summary adjudication terminating the United States' possessory interest.[16]

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[16] This conclusion is reinforced, as this Court noted in *N.H. Fire Ins.*, by 28 U.S.C. 2463, which expressly provides that "property taken or detained under any revenue law of the United States shall not be repleviable * * *." That provision requires all actions challenging the government's interest in such seized property to be litigated in federal court, in order "to protect the custody of property seized by federal revenue officers against more or less summary state court action, * * * [and by] placing these cases exclusively within the jurisdiction of the federal courts, Congress did not indicate any intention to relax or alter the safeguards of plenary proceedings * * *." 362 U.S. at 409.

2. Petitioner's suit for summary turnover is barred by Section 7421 of the Code

At bottom, petitioner's suit for summary turnover of the proceeds held by the assignee is an effort to restrain the government from completing the collection of those proceeds. That effort is barred by the explicit command of Section 7421(a) of the Code that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person * * *."

The levy constitutes a significant step in the collection process.[17] That process is completed by voluntary surrender of the property subject to levy (Section 6332(a) of the Code), liquidation or sale of that property by the United States (Section 6335 of the Code), and application of the proceeds of the levy to the taxpayer's liability (Section 6342(a) of the Code). Petitioner by his suit attempts to prevent the assignee from surrendering to the United States the property that has been levied upon, which the assignee at present holds as the government's agent, and to require the assignee to turn over that property for administration in bankruptcy. It is therefore clear that petitioner's suit is brought "for the purpose of restraining the * * * collection of [a] tax."[18] Cf. *Bob Jones University* v. *Simon*, 416 U.S. 725; *Alexander* v. *"Americans United" Inc.*, 416 U.S. 752; *United States* v. *American Friends Service Committee*, No. 73-1791, decided October 29, 1974. Accordingly, petitioner's suit is barred by Section 7421 of the Code.

[17] Section 6331(a) of the Code provides that "[i]f any person liable to pay any tax neglects or refuses to pay the same * * *, it shall be lawful for the Secretary * * * *to collect such tax* * * * *by levy* * * *" (emphasis added).

[18] In some circumstances, third persons may challenge an allegedly wrongful levy. See Section 7426 of the Code. But a receiver who asserts a claim on behalf of a bankrupt taxpayer does not fall within the scope of that provision. See H. Rep. No. 1884, 89th Cong., 2d Sess., pp. 27-29, 75-78; S. Rep. No. 1708, 89th Cong., 2d Sess., pp. 29-31.

A receiver in bankruptcy may not maintain a proceeding to restrain collection of property levied upon prior to bankruptcy, or to recover the property so collected, without first filing a claim for refund. See *United States* v. *Rochelle*, 363 F. 2d 225 (C.A. 5). Petitioner's remedy here is to await the completion of the collection process, and then, if he believes the tax to have been improperly assessed, to file a claim for refund on behalf of the bankrupt taxpayer and, if the refund is not granted, to bring a civil action for refund. See Section 7422 of the Code. That procedure, unlike petitioner's instant suit for summary turnover, would comport with this Court's observation in *Bob Jones University* v. *Simon, supra*, 416 U.S. at 736, that the principal purpose of Section 7421 of the Code is "the protection of the Government's need to assess and collect taxes as expeditiously as possible with a minimum of pre-enforcement judicial interference, 'and to require that the legal right to the disputed sums be determined in a suit for refund.' "

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

ROBERT H. BORK,
Solicitor General.
SCOTT P. CRAMPTON,
Assistant Attorney General.
KEITH A. JONES,
Assistant to the Solicitor General.
CROMBIE J. D. GARRETT,
KARL SCHMEIDLER,
Attorneys.

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